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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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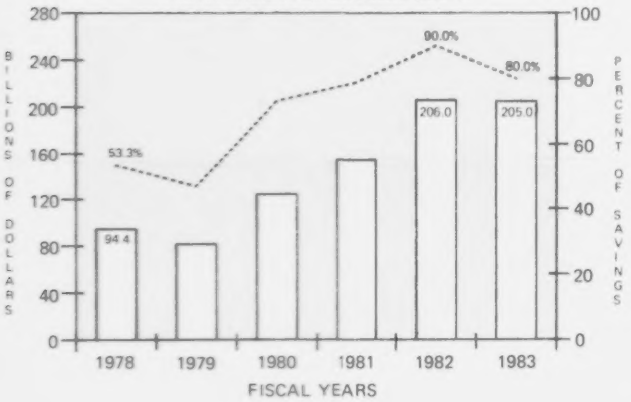
While The Budget Outlook . . .

Despite recent Administration pronouncements that the adverse effects of massive Federal budget deficits have been overstated, prospects for an ever-larger hemorrhage of red ink from Washington are now among the biggest negatives overhanging the economy and the financial markets. This trend was clearly highlighted by the just-released budget estimates for fiscal 1983 and beyond, as well as subsequent market reaction. Although a dismal budget outlook had been widely anticipated, the dimensions of the fiscal 1983 document were staggering. It included a projected deficit of $92 billion in fiscal 1983 alone and a cumulative deficit of almost $500 billion during the fiscal 1982-87 period, the near certainty of a sharp clash between expansive fiscal and restrictive monetary policies, and, as a by-product of these trends, the further devastation of large segments of corporate America. Not surprisingly, interest rates continued to lurch upward, with the prime rate again reaching 17 per cent.

TOTAL FEDERAL BORROWING (BAR) VS.
TOTAL FEDERAL BORROWING
AS A PERCENT OF SAVINGS (DOT)



While the budget deficits projected by the Administration are damaging enough, they will probably never occur. Unless Congress cuts spending drastically or enhances tax receipts, the actual deficits will be much larger than estimated. This is due to a variety of contradictions, both within and outside the budget environment, which make it improbable that the Administration's economic assumptions—and therefore revenue and expenditure estimates—will ever be realized. One of the most important of these is that high rates of economic growth will occur annually well into the 1980s, and in the process boost revenues and dampen such recession-related outlays as extended unemployment insurance benefits.

In fiscal 1983, for example, the projected growth of nominal GNP is 11 per cent, an extremely robust rate of rise when viewed in light of the current monetary policy posture of the Federal Reserve. With the Fed seemingly determined to maintain both a restrictive monetary stance as well as its current operating procedures, such a strong economic upturn would, in all likelihood, soon prompt an equally robust upturn in money supply growth—and, quite possibly, cause some credit tightening actions by the central bank. But if, indeed, this did occur, then the pace of nominal GNP growth would be lower, the real growth rate would be dampened, rates of unemployment and interest would move higher and larger-than-estimated deficits would occur.

. . . Appears Dismal . . .

Thus, the first major budget dilemma—the conflict between "loose" fiscal and "tight" monetary policies—emerges. The Administration has projected a recession-proof economy which no longer exhibits its usual cyclical variation; rather, real economic growth remains high at least until 1987, while rates of unemployment, inflation and interest all trend lower. Although this would certainly be a welcome scenario, it is unlikely to occur.

For despite these optimistic Administration projections, the central bank appears much more cautious. Unless the Federal Reserve sharply boosts its 1983 and 1984 money supply growth targets to levels well above those now prevailing it appears likely that nominal GNP growth will be closer to eight rather than 11 per cent in 1983 and somewhat lower in 1984. As a result, with the projected course of the economy and budget incompatible with that of monetary policy, the validity of both the budget's economic assumptions and deficit estimates be-

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comes suspect. If, indeed, growth rates and tax receipts are lower than estimated while unemployment rates and outlays are higher, these factors alone, together with stepped-up defense spending and interest outlays, will produce a fiscal 1983 deficit well in excess of the $92 billion red ink total now forecast.

Nor do the budget estimates seem to allow the Administration much flexibility in bringing spending and revenue totals into better alignment with the likely course of the economy and monetary policy. On the spending side, for example, defense outlays—which are so far immune to cutbacks—are slated to soar from less than 25 per cent of overall budget expenditures in fiscal 1981 to almost 35 per cent by 1985—and total almost $1 trillion during the four-year period. Interest costs will also grow significantly as the size of the Federal debt balloons, even if interest rates do fall slightly, while Social Security payments will continue to rise as long as the rate of inflation remains positive and the nation's population ages. Although the Administration expects that these almost certain spending increases will be partially offset by entitlement reforms (in such areas as Medicare and food stamps) as well as other non-defense spending cuts, this is, as of now, by no means certain—especially in a Congressional election year.

. . . A Variety Of Apparent Contradictions . . .

On the receipts side, in contrast, proposals for new tax increases are almost nonexistent, so it appears

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/10/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	134.128	– 4.094	+ 9.532
Loans to Depository Inst.	1.664	– .183	+ .551
Float	3.244	+ .519	– .194
Total Reserve Bank Credit	148.704	– 4.153	+ 9.159
Treasury Deposits with Federal Reserve Banks	5.319	– 2.544	+ 1.393
Currency Outside Banks	124.631	+ .963	+ 6.557
Member Bank Reserves:			
Required	40.531	– 1.801	+ 1.605
Excess (Deficiency)	.203	– .203	+ .033
Total Reserves Held	40.734	– 2.004	+ 1.638
Net Borrowed Reserves	1.347	+ .016	+ .535
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.024	– 3.759	+ 2.579

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	446.3	+ 12.7‡	+ 7.1‡
M2 (January '82)	1,839.3	+ 11.2	+ 10.4
M3 (January '82)	2,203.3	+ 9.7	+ 11.0
L (October '81)	2,598.2	+ 10.7	+ 11.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 2/19/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	13.30%	13.40%	13.00%
* Federal Agencies	14.55	15.05	14.70
* Project Notes—Taxfree (46% Taxable Equivalent)	14.35	14.81	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	15.20	15.20	16.00

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	14.00%	Mar.	14.55%
15- 29 days	14.13	Apr.	14.40
30- 59 days	14.38	May	14.30
60- 89 days	13.88	Jun.	14.20
90-179 days	14.25	Jul.	14.00
180-239 days	14.00	Aug.	13.80
240-270 days	14.00		

‡Industrial Paper—Prime			
30- 89 days	14.63%	†Federal Funds Effective Rate	14.25%
90-120 days	14.63		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'81	$ 2,985	$ 2,965	$ 2,731
Gross National Product (1972 Dollars)*	4th Q'81	$ 1,496	$ 1,516	$ 1,486
Percent Change, Annual Rate	4th Q'81	– 5.2	1.4	3.8
Change in Consumer Prices (all urban consumers)*	Dec '81	4.8%	6.0%	12.0%
Change in Producer Prices*	Jan '82n	4.8%	3.6%	14.4%
Civilian Employment (Thousands of Persons)†	Jan '82	99,581	99,613	99,901
Unemployment as % of Civilian Labor Force†	Jan '82	8.5%	8.8%	7.4%
Personal Income*	Jan '82n	$ 2,495	$ 2,491	$ 2,301
Leading Indicators Composite Index (1967=100)†	Dec '81	129.4	128.6	136.4
Industrial Production Index (1967=100) †	Jan '82n	139.1	143.4	151.4
Net Change in Consumer Installment Credit†	Dec '81	–$ 0.17	$ 0.34	$ 1.62
U.S. Merchandise Trade Balance †	Dec '81	–$ 0.70	–$ 3.40	–$ 2.19
Plant and Equipment Expenditures*	1st Q'82	$345.46(a)	$332.69(a)	$312.24
Private Housing Starts (Thousands of Units)*	Jan '82n	894	899	1,585
New Construction Expenditures*	Dec '81	$ 229.3	$ 231.6	$ 245.4
Total Business Inventories†	Dec '81n	$ 513.1	$ 515.2	$ 475.2
Total Business Sales†	Dec '81n	$ 343.3	$ 345.2	$ 343.8

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

unlikely that, in the absence of rapid economic growth, a sizable upturn in revenues can be counted upon to help narrow the budget gap. In fact, additional user fees (such as recreation fees at national parks), management initiatives (expanding the staff of the Internal Revenue Service) and tax revisions are expected to enhance revenues by only $30 billion in fiscal 1983—a paltry 4.5 per cent of total anticipated receipts and not all of which can be implemented without Congressional approval. And, with the Administration adamantly opposed to either scaling back or postponing the already legislated personal and business tax cuts, the second major budget dilemma emerges. This arises from the fact that even if the economy does somehow manage to escape the hammerlock of a tight monetary policy and perform as well as the Administration hopes, the budget deficits will still be staggering—and much larger than estimated because of the near certainty of large spending increases for defense, interest costs and income security, while anticipated expenditure reductions and revenue enhancements are, at best, uncertain and, at worst, unlikely.

Although the ultimate size of the fiscal 1983 deficit as well as those of subsequent years is unknown, it is certain that deficits as large as now projected could have a devastating impact upon corporate America. Sustained "crowding out" pressures would prevail in the financial markets well into the future, since the savings generated by the tax reductions

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (2/3/82)	135,383	– 98	+20,625
New York City (2/3/82)	35,205	+ 959	+ 5,970
Commercial Paper (2/3/82)	166,467	– 547	+37,292

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/3/82)	197,915	+ 2,196	+25,584
New York City (2/3/82)	56,349	+ 990	+ 5,504

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/3/82)	470,410	+ 4,178	+43,136
New York City (2/3/82)	110,967	+ 2,320	+ 9,979

Financial Markets

	Friday 2/19/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	13.70%	– 1.13	– .38
180-Day Bills†	14.34	– .91	+ .92
Longest Bills†	15.04	– .21	+ 2.48
Recent Issues:			
15 1/8s 2/29/84 (When Issued)	15.10	NA	
14 1/8s 12/31/85	14.22	– .72	
14 5/8s 2/15/92	14.00	– .97	
14s 11/15/11	13.92	– .68	
Municipals:			
Bond Buyer–20 Bond Index* (2/18/82)	12.96%	– .13	+ 2.74
Blue List Total ($ Million)	$ 755	– $ 18	+ $ 40
30-Day Visible Supply ($ Million)	$1,437	+ $125	– $ 797
Total	$2,192	+ $107	– $ 757
Corporates:			
Moody's Aa Composite (2/18/82)	15.71%	– .11	+ 1.69
30-Day Visible Supply ($ Million)	$9,412	– $290	+ $4,865
Stocks:			
Dow-Jones Averages:			
Industrials	824.30	– 10.37	– 111.79
Transportation	343.13	– 5.78	– 36.05
Utilities	104.91	– .25	– 2.36
65 Stocks	324.34	– 3.98	– 34.25
Standard and Poor's 500 Stocks	113.22	– 1.21	– 13.36
N.Y.S.E. Composite Index	65.43	– .68	– 7.02
N.Y.S.E. Avg. Daily Vol. for Week (000's)	49,234	+ 56	+ 10,068

* 46% Taxable equivalent 24.00%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/19/82	Week Ago
Overnight	15.00%	16.00%
1 month	15.50	16.13
3 month	15.63	16.31
6 month	15.69	16.31
1 year	15.50	16.19
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.95%	15.10%
Long Term (7 to 15 yrs.)	15.10	15.30

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/19/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02486	40.23
Canada	.8237	1.2141
Denmark	.1291	7.7435
France	.1668	5.9950
Germany	.4242	2.3573
Italy	.0007932	1260.70
Japan	.004305	232.28
Mexico	.02625	38.10
Netherlands	.3862	2.5895
Switzerland	.5321	1.8793
U.K.	1.8590	.5379

alone will simply not be enough to finance the projected Federal deficits.

During the fiscal 1982-84 period, for example, the cumulative deficit could reach $275 billion, with associated Treasury borrowings—both new and rollover—of about $350 billion. While this borrowing requirement would be offset in part by increased savings arising from already legislated tax reductions, it is unrealistic to expect that all, or even most, of the $270 billion to be returned to the private sector between fiscal years 1982-84 will be used to absorb the new Treasury offerings. If all these funds were saved and fully invested in Treasury securities, they would still be insufficient to finance the projected deficits. Since both of these assumptions are unrealistic, the financial markets will continue to be subjected to an ever-growing glut of Treasury securities.

In fact, it is possible that Federal and Federal-related borrowings will absorb as much as 90 per cent of the net national savings in fiscal 1982, a new record high, and approximately 80 per cent of net savings in fiscal 1983. Even when expressed as a percentage of gross national product the outlook is dismal, with total Federal and Federal-related borrowings reaching a postwar record of 6.6 per cent of GNP this year and remaining at about the same level next year. (See chart on page 1.)

. . . Makes It Even Worse

Thus, while financial market stability would seem to require that households in particular will have to save more from current income, this development, if it does occur, would produce the third major dilemma. For even if restrictive monetary policy does not forestall rapid economic growth and the economy does behave as the Administration anticipates, an abrupt upswing in household savings, while providing partially the means to finance the projected deficits, would ultimately widen them by dooming any hopes of a consumer-led economic recovery.

The near-term savings dilemma will, in fact, haunt the budget preparers well into the future. If households do cut back spending and step up savings, they limit economic growth and swell the deficits. If they do not, a limited recovery may get under way, but it will soon be choked off by the interest rate effects of rising credit demands and a restrictive monetary policy—swelling the deficits anyway. Either way, the economy loses, emphasizing once again that massive Federal deficits and monetary restraint are compatible with one another only as long as the private sector remains flat on its back.

Is there any way out of this dilemma? By the Administration's own estimates, the Economic Recovery Tax Act of 1981 will reduce personal income tax receipts by approximately $28 billion in fiscal 1982, $75 billion in fiscal 1983 and $113 billion in fiscal 1984. This suggests that restoring just the revenues lost as a result of the personal income tax cuts would go a long way toward achieving Federal financial health. The fiscal 1983 budget deficit, for example, would narrow from the now projected $92 billion to just $17 billion, while a sizable budget surplus of more than $30 billion could be registered in fiscal 1984. Such a course of action would go a long way toward dampening inflation expectations and financial market volatility—as well as bring the economy back from the brink of unparalleled fiscal excess. ■

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